ALLIANCE ENERGY INC.

1998
Annual
Report

HIGHLIGHTS

	1998	1997	1996	1995	1994	1993
FINANCIALS *($ thousand)*						
Oil & Gas Revenues	**3,567**	2,786	2,228	1,513	824	520
Funds from Operations	**1,586**	1,126	496	426	275	230
Per Share	**$ 0.11**	$ 0.09	$ 0.06	$ 0.05	$ 0.03	$ 0.04
Net Earnings (Loss)	**(3,786)**	258	(89)	22	8	41
Working capital (Deficiency)	**(827)**	(1,813)	(779)	(681)	496	1,393
Shareholders' Equity	**1,347**	4,662	3,383	3,111	2,974	3,357
Gross Capital Expenditures	**3,081**	4,170	3,579	2,336	2,415	2,148
Net Capital Expenditures	**2,921**	3,849	2,314	1,744	1,172	2,140
Long-term Debt	**3,340**	1,690	1,360			
CAPITAL STOCK *(thousand)*						
Common shares outstanding	**15,106**	14,003	9,615	8,155	7,925	7,925
PRODUCTION & RESERVES						
Yearly production *(MBOE)*	**218**	127	100	75	41	31
Average daily production *(BOE/D)*	**596**	348	274	205	113	84
Price/BOE	**$16.39**	$21.89	$22.23	$20.18	$19.97	$16.92
Proved and Probable Reserves *(MBOE)*	**2,415**	2,059	1,339	1,052	643	328
NPV reserves @ 10% *($ thousand)*	**11,243**	14,281				
NPV reserves @ 15% *($ thousand)*	**9,165**	11,612	5,640	4,055	3,387	1,725
OPERATIONS						
Wells Drilled - *Gross/Net*	**7.0/5.2**	18.0/7.2	5.0/3.0	6.0/1.9	13.0/6.6	6.0/3.4
Lands (Thousand Acres) - *Gross/Net*	**24/15**	32/20	29/20	22/15	14/8	13/7
Finding and On Stream Costs *($/BOE)*	**5.09**	4.54	5.97	3.61	3.29	5.96

TO THE SHAREHOLDERS

1998 has been a down turn year for petroleum producers due to low oil prices. The light-medium crude the Company produces in South East Saskatchewan, dropped from $24.84 per barrel to $16.79 per barrel and the heavy oil decreased form $15.44 per barrel to $10.00 per barrel. Since 98% of the Company's production is oil, we were greatly affected. At year end, when applying a price of $16.34 per barrel to our proved reserve base this resulted in a $3.8 million dollar ceiling test write-down in the assets of the Company.

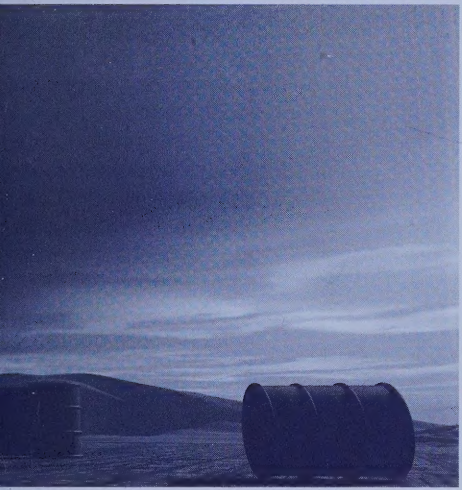
Mid-way through 1998 it became apparent that low oil prices would persist. The Company took immediate action to restrain its capital expenditures, which resulted in a 26% decrease in gross capital expenditures when compared to 1997. Despite reduced spending and low oil prices, we still managed to achieve the following positive results:

- **increased production** by 71% from 348 BOPD to 596 BOPD
- **cut operating costs** by $2.63 per barrel from $8.50 per barrel in 1997 to $5.87 per barrel in 1998
- **reduced G&A and interest expenses** from $1.59 per barrel in 1997 to $0.97 per barrel in 1998
- **maintained cash flow** net of operating, G&A, royalties and all expenses at $7.29 per barrel compared to $8.85 per barrel in 1997
- **replaced all production and increased our proved plus probable reserves** by 17% from 2.06 million BOE to 2.41 million BOE
- **increased cash flow** from $1.1 million to $1.6 million in 1998 which is $0.09 per share in 1997 to $0.11 per share in 1998
- **continued the low finding cost** at $5.09 per barrel

In an analysis of the oil price we found that had prices remained at 1997 levels, the Company's cash flow for 1998 would have been $2.86 million dollars which would equal $0.19 per share. The additional revenue received from the higher oil price would have reduced our total debt to less than $3 million dollars instead of the current $4.2 million dollars total debt, leaving us with a debt cash flow ratio of 1 to 1 instead of our present 2.7 to 1 ratio. However, since we are not in control of the oil price, we have to live within its boundaries. We view the drop in the commodity price as a challenge and a window of opportunity.

Plan of Action for the Future

The base of the Company's operations and our growth strategy has always been to find oil through exploration for medium to low risk, shallow Mississippian oil pools in South East Saskatchewan. This philosophy has kept the Company on a steady course since inception six years ago, including 1998. It is my recommendation that the Company, given its capital and human resources, remain in this field of expertise rather than shift to gas exploration. It is my



opinion that the oil price will recover long before we are able to compete successfully and deliver profitability by exploring for gas.

We have demonstrated that the Company has the expertise to find new oil pools in South East Saskatchewan. During the last two years we have successfully developed our Lost Horse Hills, Carlyle and Ingoldsby pools which were discovered in 1993 and 1994. Currently, in addition to these pools, the Company has several properties awaiting development, such as Tilston and Macoun. Our goal is to develop these pools in a prudent and cost effective manner. Our true success is measured by having low finding cost and operating costs in our area of activity when compared to our peers.

Outlook

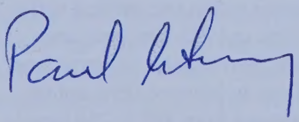
Alliance Energy looks at 1999 as a year of possibilities. We feel this is an opportune time to take advantage of the low oil prices through corporate acquisitions and/or property acquisitions. The greatest challenge will be to raise capital to further our development of prospects and participate in the acquisition activity.

If we are not successful in raising additional capital in the present market, the Company will spend its cash flow to maintain production levels without increasing our debt.

The low oil price has taken some of the "wind out of our sails", however given the cyclical nature of commodity prices, the situation will turn around. The Company is fundamentally sound and is not under any pressure to make any irrational decisions. It will continue to operate in a prudent manner to increase its Shareholders' value.

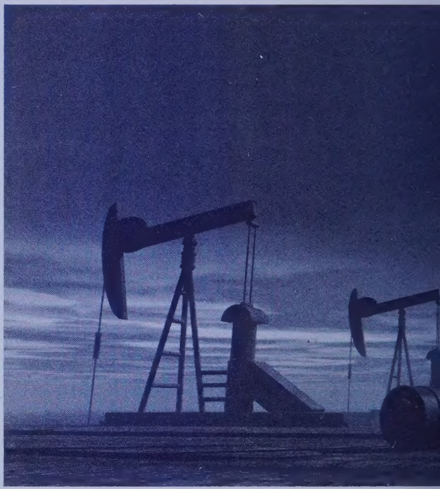
I wish to take this opportunity to thank our shareholders for your continued support. We are looking forward to seeing you at our shareholders meeting on May 5, 1999, at 3:30 p.m. at the Calgary Petroleum Club.

Respectfully submitted on behalf of the Board of Directors,



Paul Cheung,
President

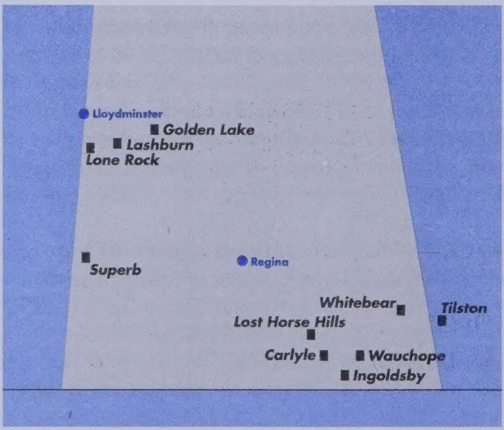
OPERATIONS REVIEW



The Company spent a total of 3.08 million dollars in capital expenditures during the year. Exploration drilling accounted for $786,000. Development drilling and equipping totaled to $978,000, while recompletions, reworks, flowline and battery construction amounted to $1,032,000. These three expenditures added up to 2.79 million dollars which was 91% of the total capital spending. Acquisition of properties and land accounted for the remaining 9%. This was consistent to our Company's growth strategy which is growth by our own exploration drilling and development of our own prospects.

Exploration Drilling

The Company has maintained its exploration effort in the S.E. Saskatchewan area looking for new shallow Mississippian oil pools at 1200 - 1400m depth. During the year we drilled four 100% working interest exploration wells at: Carlyle East, Gainsborough North, Hassard Lake, and Whitebear South with the Hassard Lake completed as a potential oil well. Unfortunately, due to low oil prices and the Company's restraining capital budget, further development drilling in Hassard Lake was postponed.

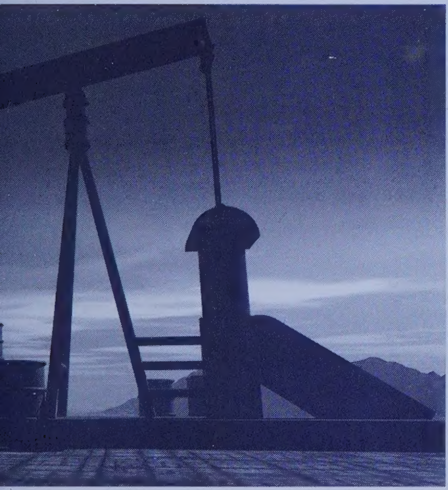


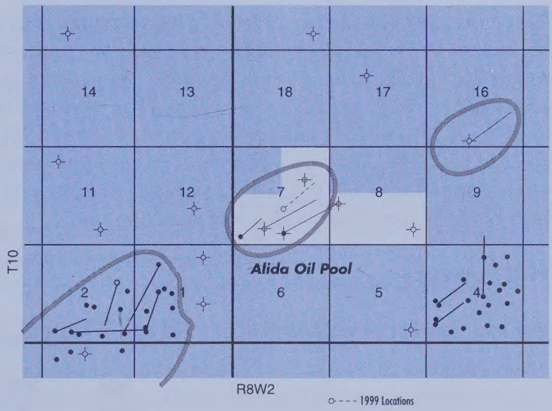
Development Drilling

During the year the Company had drilled two 50% working interest horizontal wells at Lost Horse Hills and one 24% working interest horizontal wells at Ingoldsby. Detailed discussion on these two properties as follows:

Lost Horse Hills, S.E. Saskatchewan

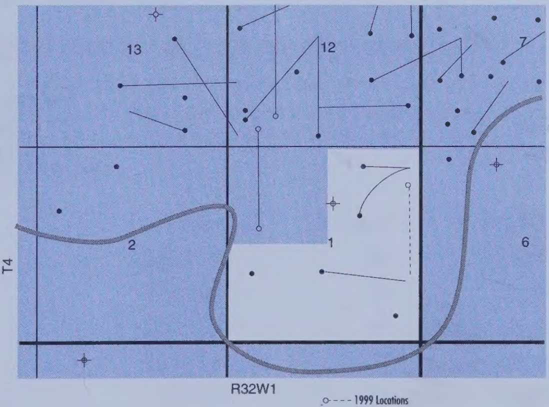
The Mississippian oil pool is at a depth of 1250m. The pool was discovered by the Company in 1993. To define the reservoir extent two vertical wells were drilled in 1993. The pool was finally developed by horizontal well drilling in 1997. To date three horizontal wells have been drilled. The first one was drilled in September 1997, the second one in January 1998 and the third one in May 1998. The initial production from these wells ranged from 360 to 750 barrels of oil per day. Presently the combined production from these three horizontal wells is 315 barrels of oil per day. During the past 18 months, the cumulative production from these three wells totals 300,000 barrels of oil and the net revenue received after all expense, exceeds 3.5 million dollars.





The Company operates this pool with a 50% working interest. The fourth horizontal well is planned for 1999. This pool is a good example of the excellent financial return from discovering a small Mississippian pool. It took relatively low initial capital investment for land, seismic, and drilling of the vertical well to find this pool. Geology for these pools is simple. Reservoir and engineering are straight forward. To date the Company has already found a number of these pools, which are the Carlyle, Ingoldsby, Tilston and Wordsworth pools.

Ingoldsby S.E. Saskatchewan



The Company drilled a 24% working interest horizontal well in our Ingoldsby property in September 1998. The well has been producing steadily at 210 barrels of oil per day. The pool was discovered by the Company in 1994 with the drilling of a vertical well. Subsequently two horizontal wells were drilled, one in 1994 and one in 1995, but the results were less than satisfactory. Since then additional geological and reservoir information was learned from wells that were drilled in this general area. This data leads us to believe our previous drilling had missed the best part of the reservoir.

Hence, we drilled a slightly different path across the reservoir in the horizontal well drilled in September 1998. The much improved production result confirmed the fact that we now have the understanding needed to develop this pool. Subsequent to year end, the Company has purchased additional working interest in the pool and has increased the average working interest from 52% to 65%. A 30% working interest horizontal well and a 100% working interest redrill well are planned for 1999. Over the years, the Company has constructed an oil processing battery, a salt water disposal well and a flowline system on this property. Additional production will enjoy a high production net back with a low operating cost.

Well Summary

The total number of wells drilled in 1998 was 7 wells (5.2 Net). The breakdown is as follows:

	Total Gross Wells	Total Net Wells	Net Oil	Net Gas	Net Salt Water Disposal	Total D&A
1998	**7.0**	**5.24**	**2.24**	**0**	**0**	**3.0**
1997	18.0	7.21	4.31	1	1	0.90
1996	5.0	3.00	1.60	0	1.30	0.10
1995	6.0	1.86	1.86	0	0	0
1994	13.0	6.62	4.69	0	1.35	0.58
1993	6.0	3.41	1.85	1	0	0.56

Land

The following is the land summary of the Company as of year end 1998.

	Total area/Acre	Producing/Acre	Non Producing/Acre
Gross	24,530	9,467	15,063
Net	14,690	5,307	9,383

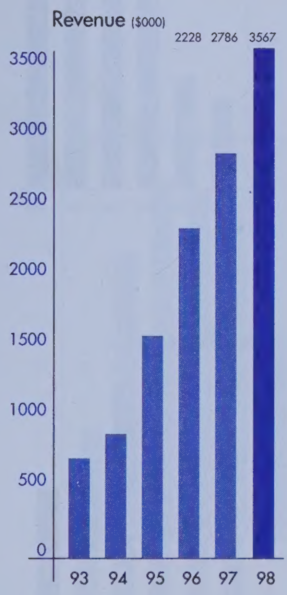
MANAGEMENT'S DISCUSSION AND ANALYSIS

Overview

The most important consideration in reviewing the results of the Company for the past year is the impact of the low oil prices, resulting in a ceiling test write-down of capital assets at year end as 99% of the reserves of the Company are oil. The average oil price received during the year was $16.39 per barrel compared to $21.89 per barrel in 1997. The book value of the capital assets of the Company have been written down by $4,075,818, net of taxes, to the value of the reserves using the average price for the year. Reserve quantities and values are discussed in more detail in the following appropriate sections.

Gross revenue and price

Gross production revenue has increased 28% in 1998 to $3,567,493 from $2,786,394 in 1997 due to a 71% increase in volume despite a 25% drop in price from $21.89 in 1997 to $16.39 in 1998.



The average price during the year for light-medium oil was $16.79/ bbl ($24.84/bbl in 1997). Medium-light oil accounted for 94% of production volume (74% in 1997). The average price for heavy oil was $10.00/bbl ($15.44/bbl in 1997). Gas accounts for less than 2% of production volume and revenue in 1998 (7% in 1997). Even though the differential between light-medium crude and heavy crude has dropped from $9.40/bbl in 1997 to $6.79/bbl in 1998, at $10/bbl the heavy oil price was too low for economic production from most wells.

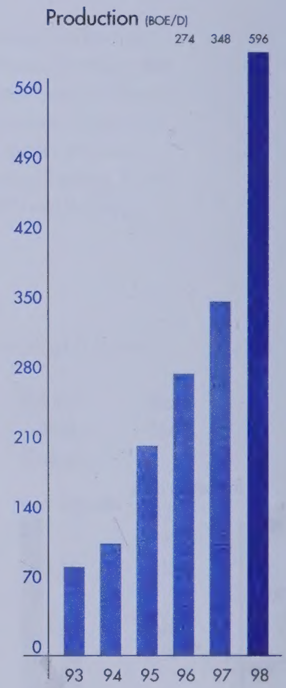
The Company did not hedge any of its production in 1998 compared to a small portion in 1997 which resulted in an increase in revenue of $19,650 in that year. Effective March 1999 until December 1999 the Company has hedged the differential between Lloyd blend and WTI at $3.50 US for 62 barrels per day of production.

Revenue	Amount	% Change	$/BOE
1998	**3,567,493**	**28**	**16.39**
1997	2,786,394	25	21.89
1996	2,228,071	47	22.23
1995	1,512,578	83	20.18
1994	824,322	58	19.97
1993	520,226	-	16.92

Production

Production volume for the year was 217,668 BOE, an increase of 90,371 BOE, or 71% from 1997. The higher volumes are attributable to the successful horizontal drilling in 1998 and 1997 of Lost Horse Hills, Ingoldsby and Carlyle prospects. The average daily production for the Company in 1998 was 596 BOE compared to 348 BOE in 1997. Production remained fairly consistent throughout the year with new production found replacing production lost through decline. The Company exited the year with a daily production rate of 524 BOE producing from 44 wells. Light-medium oil accounts for 94% of production volume (74% in 1997); heavy oil accounts for 4% of production volume (19% in 1997) and gas accounts for 2% of production volume (7% in 1997). Approximately 200 barrels of potential heavy oil production is shut-in awaiting prices to improve.

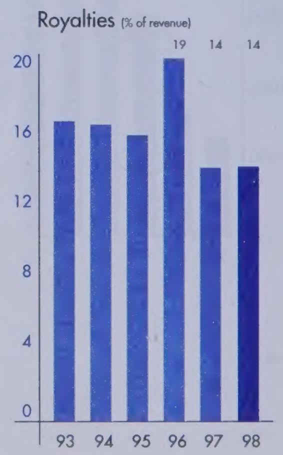
Production	Total BOE	% Change	BOE/D
1998	**217,668**	**71**	**596**
1997	127,297	27	348
1996	100,208	34	274
1995	74,962	82	205
1994	41,279	34	113
1993	30,739	-	84



Royalties

Royalties for the period were $492,669, or 14% of revenues. Last years royalties of $375,316 were also 14% of the revenues. Royalties decreased slightly on a BOE basis from $2.95 in 1997 to $2.26 in 1998 as a direct reflection of the oil price. The Company continues to benefit from the royalty reduction holiday on production from new horizontal wells drilled.

Royalties	Amount	% of Revenue	$/BOE
1998	**492,669**	**14**	**2.26**
1997	375,316	14	2.95
1996	424,779	19	4.24
1995	226,288	15	3.02
1994	129,768	16	3.14
1993	83,855	16	2.73

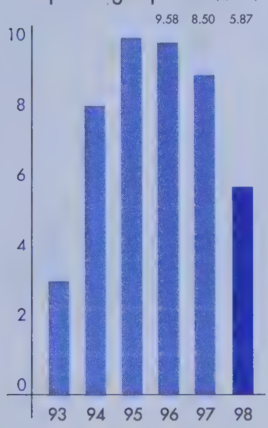


Operating expenses

Operating expenses for the year was $1,278,259 compared to $1,082,190 in 1997 as a result of the increase in production volume. On a BOE basis the operating costs were reduced by 31% from $8.50/BOE in 1997 to $5.87/BOE in 1998.

The primary reason for the decrease in operating costs per BOE is that the Company now benefits from the investment made in the early years to construct processing facilities in key prospects, such as Lost Horse Hills, Ingoldsby and Carlyle. The operating costs for these pools are now greatly reduced. In previous years when operating costs have been in the $8 -$10 range, it was because the Company had not had the time and capital to install proper facilities in the pools found. A further reason for the reduction of operating costs on a BOE basis was the reduction of heavy oil production. Heavy oil production is considerably more expensive to operate than light-medium crude. Our heavy oil production has decreased from 19% of the production in 1997 to 4% in 1998.

Operating Expenses ($/BOE)



The Company's operations are focused in one area, namely S.E. Saskatchewan and is now operating 60 wells and batteries in this area. This gave the Company the critical size to set up a field office in Estevan, Saskatchewan with 3 employees rather than using consultants. The Company now has the capability to double its field operations with no increase in field office costs. Our three employees handle supervision on the Company's drilling, completion and construction operations as well as the day to day production operations.

The Company expects operating costs to continue to be around $5.00/BOE for our S.E. Saskatchewan production.

Operating Expense	Amount	% of Revenue	$/BOE
1998	**1,278,259**	**36**	**5.87**
1997	1,082,190	39	8.50
1996	959,597	44	9.58
1995	720,248	49	9.61
1994	322,115	41	7.80
1993	90,257	18	2.94

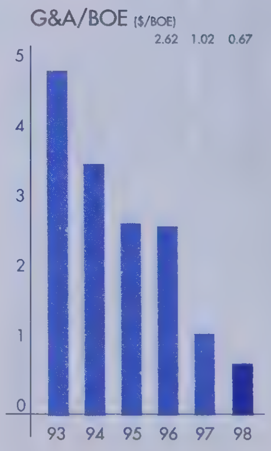
Netbacks and Cash Flow per BOE

The following table summarizes the Companys production netbacks and cash flow on a BOE basis after general and administrative expenses (G&A) and interest expenses.

	Average Sale Price	Royalty	Operating Expenses	Production Netback	G&A Expenses	Interest & Other Expenses	Cash Flow
	$/BOE	$/BOE	$/BOE	$/BOE	$/BOE	$/BOE	$/BOE
1998	**16.39**	**2.26**	**5.87**	**8.26**	**0.67**	**0.30**	**7.29**
1997	21.89	2.95	8.50	10.44	1.02	0.57	8.85
1996	22.23	4.24	9.58	8.41	2.62	0.84	4.95
1995	20.18	3.02	9.61	7.55	2.77	(0.90)	5.68
1994	19.97	3.14	7.80	9.03	3.29	(0.93)	6.67
1993	16.92	2.73	2.94	11.25	5.00	(1.24)	7.49

General and Administrative Expenses (G&A)

General and administrative expense for the year was $146,847 in 1998 compared to $129,618 in 1997, primarily due to the expense of establishing the field office in Estevan. On a BOE basis the general and administrative expenses have decreased from $1.02/BOE in 1997 to $0.67/BOE in 1998. Our G&A expenses at $0.67/BOE are considerably lower than the industry average for companies with similar production volume. This is due to the fact that our office staff are well trained, qualified and versatile. The Company operates all its wells with an average working interest of 50%, therefore recoveries from overhead charges also help to reduce the G&A expenses. A portion of the salary paid to the geological staff has been capitilized, totalling $127,737, as these employees are directly involved in the exploration and development process. The Company does not capitalize any indirect general and administrative expenses.



Interest Expense

Interest expense was $180,736 in 1998 compared to $73,197 in 1997. The increase is attributable to the higher debt carried by the Company to finance its capital activities.

Depreciation and depletion

The provision for depreciation and depletion for 1998 includes the write-down of 4,075,818 ($3,760,823 net of tax). The write-down is the result of applying the ceiling test evaluation at November 30, 1998 . This test applied the average oil price, excluding royalty income, of $16.34 to the Company's proved reserves minus the future general and administrative expenses, future site restoration and abandonment costs, interest expense and income taxes and compares this value to the book value of capital assets. The resulting short fall was the ceiling test write-down.

One of the future benefits of recognizing the write-down of capital assets is that the depreciation and depletion charge in the future will be lower, therefore net earnings will improve accordingly. The Company expects the depreciation and depletion cost to be less than $5.00/BOE in 1999.

Investments

In 1997 the Company had invested a total of $250,000 in establishing Advance Drilling Ltd, a drilling company that owns 1 drilling rig and manages 2 other drilling rigs. At that time there was a severe shortage of drilling rigs, and as drilling rigs have become more available, the Company no longer needs to control a drilling company; therefore effective January 1, 1999 the Company sold 86% of its equity investment.

During the year the Company recorded a management fee of $89,622 from Advance Drilling Ltd. and had earned interest income of $32,643.

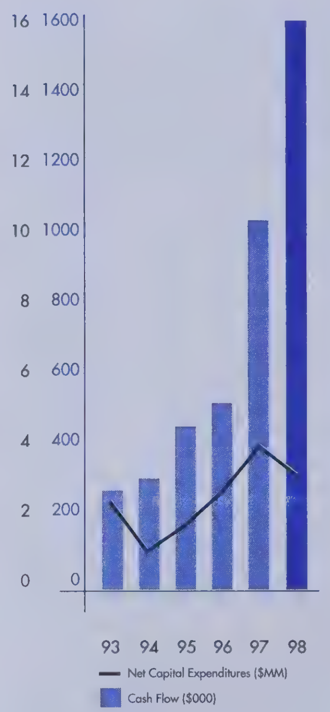
On a cash basis, after taking into consideration management fees paid, interest income and the sale of shares, the Company has made a profit of $198,000 in the last one and a half years on this investment.

Changes in Financial Position, Cash Flow and Net Earnings

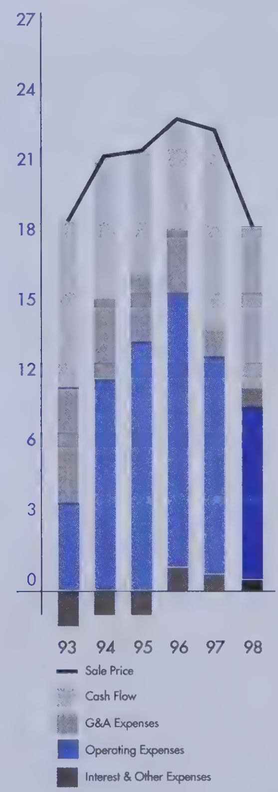
Total capital expenditures for the year were $3,081,033, down significantly from expenditures of $4,170,191 in 1997 as the Company had made the decision to be prudent in its capital expenditures in view of the lower oil prices. The expenditures were primarily funded by cash flow, drawdown of the bank line of credit, issuance of common shares and the sale of Advance Drilling shares.

The Company's cash flow from operations for the year was $1,585,982

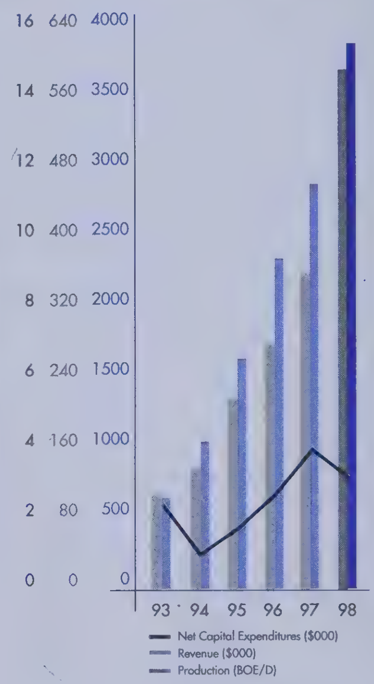
Cash Flow



Composite Expenses



Composite Revenue



compared to $1,126,073 in 1997. The Company has achieved this increase in cash flow by increased production, while reducing operating expenses and general and administrative expenses on a BOE basis.
Cash flow for 1998 would have been 2.8 million dollars if it were not for the $8.05 drop in the price of light-medium oil.

In 1998 the Company recorded a net loss of $3,786,330 compared to net earnings in 1997 of $257,650 due to the ceiling test write-down after taxes of $3,760,823. In December 1997, the Company issued 1,000,000 common shares for $450,000 pursuant to warrants granted in conjunction with the Special Warrant Offering in 1996. Proceeds from sale of minor properties were $160,154. Additional drawdown of the bank line of credit was $1,670,000.

Capital Expenditures

Capital expenditures decreased 26% from $4,170,191 in 1997 to $3,081,033 in 1998. The following table shows the breakdown of capital expenditures for the year.

	1998	1997	1996	1995	1994	1993
Geological and Geophysical	**17,964**	36,708	16,307	52,334	92,456	338,615
Land Costs	**56,836**	124,920	3,229	186,041	124,161	185,608
Drilling, Completion and Equipping	**2,685,221**	2,773,305	1,298,023	1,005,147	1,616,084	793,555
Batteries and Flowlines	**113,888**	352,985	483,438	225,990	478,602	125,797
Acquisitions of Producing Properties	**120,224**	873,429	1,731,326	866,177	104,000	704,300
Other	**86,900**	8,844	46,936	0	0	0
TOTAL	**3,081,033**	4,170,191	3,579,259	2,335,689	2,415,303	2,147,875

Of the total capital expenditures $2,870,384 (93%) was for light-medium oil activity and $210,649 (7%) was for heavy oil activity.

Quarterly analysis

				1997				**1998**
	1 Q	2 Q	3 Q	4 Q	**1 Q**	**2 Q**	**3 Q**	**4 Q**
Production (MBOE)	26	24	29	48	**58**	**57**	**56**	**47**
Price per BOE	$23.57	$23.27	$17.41	$22.73	**$17.53**	**$15.97**	**$14.72**	**$17.24**
Revenue ($ thousands)	615	576	508	1087	**1019**	**915**	**821**	**812**
Funds from operations ($ thousands)	207	144	49	726	**512**	**350**	**395**	**329**
Earnings ($ thousands)	45	3	(32)	242	**106**	**(37)**	**(4)**	**(3851)**
Funds from operations per share	$0.02	$0.01	$0.01	$0.05	**$0.04**	**$0.02**	**$0.03**	**$0.02**

Oil and Gas Reserves

The Company had twelve of its major producing properties evaluated by Gilbert Laustsen Jung Associates Ltd. as at December 1, 1998. The following is a summary of the evaluation of the Company's net reserves of which 95% were evaluated by Gilbert Laustsen Jung Associates Ltd. and 5% were evaluated internally.

The Company was successful in finding additional reserves despite a 26% reduction in gross capital expenditures. The Company increased its proved and probable reserves by 17% after replacing the current years production as shown below.

	Proven (MBOE)	Proven and Probable (MBOE)
As of December 1, 1997	1,529	2,059
Net additions	285	574
Production	(218)	(218)
As of November 30, 1998	**1,596**	**2,415**

Gas reserves are converted to BOE at ten to one ratio.

Net additions are composed of net reserves found and purchased, less dispositions and adjustments.

Oil reserves account for 99% of total reserves and gas accounts for 1%.

Finding and On-stream Costs

The finding and on-stream costs for the Company are based on net capital expenditures and net proven and probable reserves additions. Net capital expenditures for 1998 were $2,920,879 being total capital expenditures less proceeds from sale of properties.

	Gross Capital Expenditures	Proceeds on sale of Properties	Net Capital Expenditures	Finding costs BOE
1998	**3,081,033**	**(160,154)**	**2,920,879**	**5.09**
1997	4,170,191	(321,498)	3,848,693	4.54
1996	3,579,259	(1,264,714)	2,314,545	5.97
1995	2,335,689	(591,708)	1,743,981	3.61
1994	2,415,303	(1,243,124)	1,172,179	3.29
1993	2,147,875	(8,000)	2,139,875	5.96

Net asset value

Despite a 17% increase in proved and probable reserves, the net asset value of the reserves discounted at 10% has dropped by 21% due to the reduced oil price forecasts used in the evaluation. Ninety nine percent of the total reserves of the Company are oil, therefore the value of the Company is directly related to oil prices.

The following is a summary of the net asset value of the Company.

Net Asset Value
($ thousands)

	1998	1997	1996	1995	1994	1993
Reserves, proved and probable @ 10% NPV	**11,243**	14,281				
Reserves, proved and probable @ 15% NPV			5,640	4,055	3,387	1,725
Undeveloped land	**418**	609	477	286	378	318
Investments	**107**	216				
Working capital (deficiency)	**(827)**	(1,813)	(779)	(681)	496	1,393
Long-term debt	**(3,440)**	(1,690)	(1,360)			
Net Asset Value	**7,501**	11,603	3,978	3,660	4,261	3,436
Shares outstanding (thousands)	**15,106**	14,003	9,615	8,155	7,925	7,925
Net Asset Value Per Share	**$0.50**	$0.83	$0.41	$0.45	$0.54	$0.43

1998 Net Asset Value with Reserves Discounted at 15%
($ thousands)

Net Asset Value	5,423
Net Asset Value Per Share	$0.36

Year 2000 Status

The Company has addressed the Year 2000 issue. The Company has contacted the suppliers of all software applications to confirm their compliance. The Company will need to upgrade its accounting system for $3,000 during 1999.

While the Company believes that it will be Year 2000 compliant, it recognizes that it is dependent upon the ability of its vendors and purchasers to also be compliant.

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

All of the information in the annual report and accompanying consolidated financial statements are the responsibility of management. The consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. Where necessary, management has made judgments and estimates in preparing the consolidated financial statements, and such statements have been prepared within acceptable limits of materiality. The financial information contained elsewhere in the annual report has been reviewed to ensure that it is consistent with the consolidated financial statements.

Management maintains appropriate systems of internal control to give reasonable assurance transactions are appropriately authorized, that its assets are safeguarded, and that financial records are properly maintained to provide reliable information for the preparation of the consolidated financial statements.

An independent firm of chartered accountants, PricewaterhouseCoopers, LLP, as appointed by the shareholders, examines the consolidated financial statements in accordance with generally accepted auditing standards in Canada and provide an independent professional opinion.

The Audit Committee of the Board of Directors has reviewed the consolidated financial statements with management and the external auditors. The consolidated financial statements have been approved by the Board of Directors on the recommendation of the Audit Committee.

Paul Cheung

Paul Cheung,
President, C.E.O.
Calgary, Alberta

AUDITORS' REPORT

To the Shareholders of Alliance Energy Inc.

We have audited the consolidated balance sheets of **Alliance Energy Inc.** as at November 30, 1998 and 1997 and the consolidated statements of earnings (loss) and retained earnings (deficit) and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at November 30, 1998 and 1997 and the results of its operations and its cash flows for the years then ended in accordance with generally accepted accounting principles.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers, LLP
Chartered Accountants
February 26, 1999

ALLIANCE ENERGY

Consolidated Balance Sheet as at November 30, 1998 and 1997

	1998 $	1997 $
Assets		
Current assets		
Cash	-	49,376
Accounts receivable (notes 2 and 7)	794,106	2,031,781
Investments (note 2)	100,867	-
Prepaid expenses and drilling deposits	71,996	60,951
	966,969	2,142,108
Investment (note 2)	107,205	216,000
Capital assets (note 3)	5,742,941	8,404,353
	6,817,115	10,762,461
Liabilities		
Current liabilities		
Bank indebtedness	30,967	-
Accounts payable	1,703,021	3,815,270
Long-term debt (note 4)	60,000	140,000
	1,793,988	3,955,270
Long-term debt (note 4)	3,440,000	1,690,000
Provision for site restoration costs	235,671	139,533
Deferred taxes	-	315,671
	5,469,659	6,100,474
Shareholders' Equity		
Capital stock (note 5)	4,915,701	4,443,902
Retained earnings (deficit)	(3,568,245)	218,085
	1,347,456	4,661,987
	6,817,115	10,762,461

Accompanying notes are integral to the financial statements.

Approved by the Board of Directors

Paul [signature] Director

[signature] Director

ALLIANCE ENERGY

Consolidated Statements of Earnings (Loss) and Retained Earnings (Deficit)
for the years ended November 30, 1998 and 1997

	1998 $	1997 $
Revenue		
Oil and gas production	3,556,329	2,774,504
Royalties	(492,669)	(375,316)
Net production revenue	3,063,660	2,399,188
Royalty revenue	11,164	11,890
Management fee income from equity investment	89,622	-
Equity in income of affiliate	18,500	56,000
	3,182,946	2,467,078
Expenses		
Operating expenses	1,278,259	1,082,190
Depreciation, depletion and amortization (note 3)	5,678,429	726,556
General and administrative	146,847	129,618
Interest	180,736	73,197
	7,284,271	2,011,561
Earnings (loss) before income taxes	(4,101,325)	455,517
Income taxes		
Deferred expense (recovery) (note 6)	(314,995)	197,867
Net (loss) earnings for the year	(3,786,330)	257,650
Retained earnings (deficit) - Beginning of year	218,085	(32,602)
Preferred share dividends	-	(6,963)
Retained earnings (deficit) - End of year	(3,568,245)	218,085
Net (loss) earnings per share	(0.25)	0.02

Accompanying notes are integral to the financial statements.

ALLIANCE ENERGY

Consolidated Statements of Cash Flow for the years ended November 30, 1998 and 1997

	1998 $	1997 $
Cash flows from operating activities		
Net (loss) earnings for the year	(3,786,330)	257,650
Items not affecting cash		
Equity in income of affiliate	(18,500)	(56,000)
Additional cash portion of management fee income	27,378	-
Depreciation, depletion and amortization	5,678,429	726,556
Deferred income taxes	(314,995)	197,867
Funds from operations	1,585,982	1,126,073
Net change in non-cash working capital	(885,619)	995,909
	700,363	2,121,982
Cash flows from financing activities		
Net proceeds of issuance of common shares for cash	471,123	1,615,415
Issuance of long-term debt	1,670,000	470,000
Redemption of preferred shares	-	(90,000)
Preferred share dividend	-	(6,963)
	2,141,123	1,988,452
Cash flows from investing activities		
Capital assets expenditures	(3,081,033)	(4,170,191)
Proceeds on sale of capital assets	160,154	321,498
Investment	(950)	(160,000)
	(2,921,829)	(4,008,693)
Decrease in cash for the year	(80,343)	101,741
Cash (bank indebtedness) - Beginning of year	49,376	(52,365)
(Bank indebtedness) cash - End of year	(30,967)	49,376
Funds from operations per share	0.11	0.09
Fully diluted funds from operations per share	0.10	0.08
Cash and short-term deposits are comprised of		
Cash and short-term deposits	-	49,376
Bank indebtedness	(30,967)	-
	(30,967)	49,376

Accompanying notes are integral to the financial statements.

ALLIANCE ENERGY

1) Summary of significant accounting policies

Consolidation

These financial statements represent the accounts of Alliance Energy Inc. and its wholly-owned subsidiary, Alliance Resources Inc. On April 30, 1997 Alliance Energy Inc. amalgamated with its subsidiary 674049 Alberta Inc.

Capital assets

Petroleum and natural gas properties

The Company follows the full cost method of accounting for exploration and development expenditures whereby all costs, net of incentives, related to the exploration for and development of oil and gas reserves are capitalized. Costs include lease acquisition, geological and geophysical expenditures, carrying costs of non-productive properties, the drilling of productive and non-productive wells and related plant and production equipment costs.

The Company calculates a "cost ceiling" which limits the net book value of capital costs to the undiscounted and unescalated estimated future net revenues from production of proved reserves based upon year-end prices. This test also accounts for future general and administrative expenses, future site restoration and abandonment costs, financing costs and income taxes, all undiscounted and unescalated. Additional depletion is provided if the net book value of capitalized costs exceeds such future revenue.

Depletion is computed using the unit-of-production method where the ratio of production to proved reserves, before royalties, determines the proportion of depletable costs to be expensed. Undeveloped properties are excluded from the depletion calculation until the quantities of proved reserves can be determined.

Other assets

Depreciation on office equipment is computed on the declining balance method at the rate of 20% per year.

Site restoration

The estimated costs for future site restoration and abandonments are provided for on a unit-of-production basis. The estimates are based upon current regulations and industry standards in effect at year-end. The annual charge is recorded as site restoration and the actual site restoration costs are charged to the site restoration provision as incurred.

Income taxes

Income taxes are provided at current rates for all items included in the statement of income

ALLIANCE ENERGY

regardless of the period when such items are reported for income tax purposes. The principal items which result in timing differences for financial and tax reporting purposes arise from claiming capital cost allowance and exploration and development expenses in excess of depreciation and depletion charged against income.

Joint ventures

A significant portion of the Company's exploration, development and production activities are conducted jointly with other entities and accordingly the accounts reflect only the Company's proportionate interest in such activities.

Investments

Equity investments are carried at initial cost, less dividends received, plus the Company's share of equity income.

Hedging activities

Settlement of crude oil price swap agreements, which have been arranged as a hedge against commodity price fluctuations, are reflected in production revenues at the time of sale of the related hedged production.

Per share information

Earnings per share and cash flow per share are based on the weighted average number of shares outstanding during the year of 15,016,886 (1997 - 12,776,382).

(2) Investment

	1998 $	1997 $
Common shares	70,500	70,000
Equity earnings	47,122	56,000
Promissory note	180,900	180,000
	298,522	306,000
Comprised of		
Current accounts receivable	90,450	90,000
Current investment	100,867	--
Long-term investments	107,205	216,000
	298,522	306,000

ALLIANCE ENERGY

The Company has an investment in Advance Drilling Ltd. ("Advance"), in the amount of $70,500, representing 702,000 common shares. This investment represents 23.4% of the issued and outstanding shares of Advance and as a result, the Company equity accounts this investment.

The Company has loaned Advance $180,900 pursuant to an unsecured promissory note which bears interest at 10%. The promissory note was to be repaid in two equal instalments at June 1, 1998 and June 1, 1999, however, these instalments have been deferred to June 1, 1999 and June 1, 2000 and, accordingly $90,450 has been classified as accounts receivable in 1998 (1997 - $90,000).

Effective January 1, 1999, the Company sold 602,000 common shares of its total investment of 702,000 common shares for cash proceeds of $124,344, and consequently, $100,867 has been reclassified as a current investment at November 30, 1998. This transaction is contingent on the approval of the board of directors of Advance. The determination of the proceeds was based on an independent valuation of Advance assets.

(3) Capital assets

Capital assets are comprised of:

			1998
	Cost	**Accumulated Amortization**	**Net**
	$	**$**	**$**
Petroleum and natural gas properties	**8,969,705**	**6,368,625**	**2,601,080**
Production equipment and facilities	**4,036,129**	**996,294**	**3,039,835**
Other assets	**165,422**	**63,396**	**102,026**
	13,171,256	**7,428,315**	**5,742,941**

			1997
	Cost	Accumulated Amortization	Net
	$	$	$
Petroleum and natural gas properties	6,649,183	1,328,051	5,321,132
Production equipment and facilities	3,546,742	499,392	3,047,350
Other assets	78,521	42,650	35,871
	10,274,446	1,870,093	8,404,353

ALLIANCE ENERGY

Undeveloped property costs of $418,469 (1997 - $609,135) have been excluded from capitalized costs subject to depletion.

As a result of applying the ceiling test evaluation at November 30, 1998, the Company recorded a write-down of its oil and gas properties of $4,075,818 ($3,760,823 net of a deferred tax recovery of $314,995). The ceiling test was calculated using a yearly average price of $16.34 Cdn. per barrel. If the Company had used its realized November 1998 oil price of $15.86 Cdn., a further write-down of $547,171 would have been recorded.

(4) Long-term debt

	1998 $	1997 $
Bank debt	3,100,000	1,350,000
Loan	400,000	480,000
	3,500,000	1,830,000
Less: Current portion	(60,000)	(140,000)
	3,440,000	1,690,000

Bank loan

The Company has a demand revolving production term loan facility in the amount of $3,200,000 with a Canadian bank. As at November 30, 1998, the current amount outstanding against this facility was $3,100,000 (1997 - $1,350,000). Interest is charged on the borrowings under the facility at the bank's prime rate plus 3/4 % per annum. Collateral for this facility is provided by a fixed and floating charge debenture of $3,000,000 over all assets of the Company, together with a promissory note in the amount of $3,200,000 and a postponement of claims by an industry partner pursuant to the loan referred to below.

At November 30, 1998, the Company is in default of a number of covenants under its loan facility. The Company's bank will not waive these breaches until completion of their annual review which is expected to be completed by mid April. Management is of the opinion based on the Company's proved reserves at November 30, 1998, that no portion of the balance outstanding at November 30, 1998 will become due and payable in the next twelve months. In the event that the loan facility available to the Company is reduced, then a portion of the amount shown as long-term debt may become due and payable in the next twelve months.

Loan

As at November 30, 1998 the Company has a loan of $400,000 from an industry partner.

ALLIANCE ENERGY

Collateral provided on this loan is subordinated to the collateral provided to the bank and interest is charged at 7.5% per annum. Principal repayments commenced May 1, 1998, and all principal is to be repaid by May 1, 2000. Of the loan balance, an amount of $60,000 will be repaid in 1999, and accordingly this amount has been classified as a current liability.

(5) Capital stock

Authorized

- Unlimited number of common shares without nominal or par value
- Unlimited number of preferred shares without nominal or par value
- Unlimited number of preferred series one shares without nominal or par value.

	Common		Preferred		Total
Issued and issuable	**Number of shares**	**$**	**Number of shares**	**$**	**$**
Balance -- November 30, 1996	9,615,361	3,325,298	150,000	90,000	3,415,298
Shares issued pursuant to issue of Special A Warrants	2,000,000	800,000	-	-	800,000
Flow-through shares issued pursuant to issue of Special B Warrants (net of tax effect of $440,000)	2,222,222	560,000	-	-	560,000
Issued under stock options plan	165,000	36,300	-	-	36,300
Tax effect on private placement of flow-through shares issued in 1996	-	(154,000)	-	-	(154,000)
Share issue costs, net of tax benefits of $97,189	-	(123,696)	-	(123,696)	
Redeemed for cash	-	-	(150,000)	(90,000)	(90,000)
Balance - November 30, 1997	14,002,583	4,443,902	-	-	4,443,902
Exercise of warrants	1,000,000	450,000	-	-	450,000
Issued under stock options plan	103,000	22,660	-	-	22,660
Share issue costs, net of tax benefit of $676	-	(861)	-	-	(861)
Balance - November 30, 1998	**15,105,583**	**4,915,701**	**-**	**-**	**4,915,701**

On December 20, 1996, the Company issued 2,000,000 Special A Warrants at $0.40 per warrant for gross proceeds of $800,000. Each Special A Warrant entitles the holder to acquire one common share and one-half of one Warrant at no additional cost. Each Warrant entitled the holder thereof to acquire one common share, at a price of $0.45 to December 20, 1997, subject to forced

ALLIANCE ENERGY

conversion by the Company, if at any time the 30 day weighted trading price of the common shares exceeds $0.75. In addition, the Company issued 2,222,222 Special B Warrants at $0.45 per warrant for gross proceeds of $1,000,000. Each Special B Warrant entitles the holder to acquire one common share on a flow-through basis at no additional cost.

On March 6, 1997 the Company filed a prospectus with the Alberta Stock Exchange qualifying the Special Warrants for conversion to common shares.

On December 20, 1997 the 1,000,000 warrants issued pursuant to the Special A Warrants were exercised for cash proceeds of $450,000.

During 1997, the preferred shares were redeemed at a price of $0.60 per share and the shares were subsequently cancelled.

At November 30, 1998, 1,491,500 stock options (1997 - 1,053,500) were outstanding to directors, officers, employees and consultants of the Company. These stock options are exercisable at prices between $0.22 and $0.65 and expire between April 1, 1999 and July 1, 2002. During the year 103,000 stock options were exercised, 12,000 expired and 553,000 new options were issued.

(6) Income taxes

The provision for income taxes reflects an effective tax rate which differs from the expected Canadian income tax rate as summarized below:

	1998	1997
	$	$
Earnings (loss) before income taxes	**(4,101,325)**	455,517
Expected tax expense at 44.58% (1997 - 44.58%)	**(1,828,371)**	203,069
Depletion, depreciation and amortization not deductible for income tax purposes	**329,524**	60,986
Crown royalties	**133,700**	88,034
Resource allowance	**(162,943)**	(125,636)
Equity income in affiliate	**(8,247)**	(24,965)
Other	**2,518**	(3,621)
Cash portion of management fee income	**12,205**	-
Future tax benefit of losses not recognized	**1,206,619**	-
Tax recovery reflected in accounts	**(314,995)**	197,867

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At November 30, 1998, the Company has tax pools in the amount of $7,339,000 (1997 - $5,872,214).

The unrecorded benefit of the excess tax pools of approximately $1,088,000 has not been recognized in the Company's financial statements as at November 30, 1998.

(7) Related party transactions

In 1997, the Company initiated the formation of a drilling company, Advance Drilling Ltd. (refer to note 2). Certain directors of the Company have an ownership interest of approximately 10% in Advance and during the year the Company contracted a drilling rig owned by Advance under normal business terms and conditions. Advance currently shares certain office accommodation and services with the Company and pays its share of such costs based on usage.

At November 30, 1998, Advance owed the Company $181,514 (1997 - $737,992), which has been included in amounts receivable. Accounts receivable balances due from Advance bear interest at 10% per annum. Effective January 1, 1999, the Company sold 602,000 shares to existing shareholders of Advance, which includes two individuals who are directors of the Company.

In addition, the Company is owed $64,000 (1997 - $35,300) by a company controlled by a director of the Company.

During 1998, the Company charged management fees in the amount of $89,622 (1997 - $nil) to Advance.

(8) Financial instruments

The Company's financial instruments recognized in the financial instruments consist of cash accounts receivable, deposits, note receivable, accounts payable and long-term debt.

The fair value of the cash, accounts receivable, deposits, note receivable and accounts payable approximate their carrying amounts due to the short-term maturity of these financial instruments. The fair value of the Company's floating rate long-term debt approximates its carrying amount as the interest rate is at a commercial lending rate, while the fair value of the fixed rate long-term debt approximates its carrying amount.

ALLIANCE ENERGY

(9) Uncertainty due to the Year 2000 Issue

The Year 2000 Issue arises because many computerized systems use two digits rather than four to identify a year. Date-sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using year 2000 dates is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date. The effects of the Year 2000 Issue may be experienced before, on, or after January 1, 2000, and, if not addressed, the impact on operations and financial reporting may range from minor errors to significant systems failure which could affect an entity's ability to conduct normal business operations. It is not possible to be certain that all aspects of the Year 2000 Issue affecting the entity, including those related to the efforts of customers, suppliers, or other third parties, will be fully resolved.

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Corporate Information

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Fred Dyment*
President, Ranger Oil Limited
Calgary, Alberta

D.M. (Bud) McDonald*
President, McDonald Oil & Gas Ltd.
Calgary, Alberta

Donald R. Planche*
President, Flagship Investments Ltd.
Calgary, Alberta

**Members of the Audit Committee*

OFFICERS AND KEY PERSONNEL

Paul Cheung, P. Geol.
President & CEO

Merlin Skjonsby
VP, Operations

Ailsa Brereton, CA
Controller

Brian Skjonsby
Field Supervisor

Julie VanBoeyen
Accounting

BANKERS

Alberta Treasury Branch
Calgary, Alberta

AUDITORS

PricewaterhouseCoopers LLP
Calgary, Alberta

SOLICITORS

Blain & Company
Calgary, Alberta

REGISTRAR AND TRANSFER AGENT

Olympia Trust Company
Calgary, Alberta

STOCK EXCHANGE LISTING

Alberta Stock Exchange
Stock trading Symbol "AEI"

ABBREVIATIONS

BOPD	Barrels of oil per day
BOE	Barrels of oil equivalent (10 Mcf = 1 BOE)
BOE/D	Barrels of oil equivalent per day
Mbbls	Thousand barrels of oil
Mmcf	Million cubic feet of gas
Mcf	Thousand cubic feet of gas
MBOE	Thousands of BOE

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